Georgia Tech Financial Analysis Lab
800 West Peachtree Street NW
Atlanta, GA 30332-0520
404-894-4395
http://www.mgt.gatech.edu/finlab

Dr. Charles W. Mulford, Director
INVESCO Chair and Professor of Accounting
charles.mulford@mgt.gatech.edu

Brandon Miller
Graduate Research Assistant
brandon.miller31@gatech.edu

Cash Flow Trends and Their Fundamental Drivers: Comprehensive Review (Qtr 4, 2009)

FREE CASH MARGIN:

2.43, 4.12	6.56	5.14
Recession Low (Mar. 2001, Dec. 2008)	**Current (Dec. 2009)**	**Previous Expansion High (June, 2004)**

Despite declining revenues, free cash margin improved during the four quarters ended December 2009 to 6.56%, the highest recorded reading since we began collecting data in March 2000. That measure is up from 5.36% for the four quarters ending September 2009. Driving the increase in free cash margin were improvements in gross margin and a reduction in capital expenditures as a percent of revenue offset by an increase in the cash cycle, caused by an increase in inventories and receivables. Companies have now reduced capital spending each quarter since March 2008. For the four quarters ending December 2009, capital spending as a percent of revenue stood at a recession low of 2.82%, down from 3.02% in the period ended September 2009. Our expectation is that as the economy grows, it will be necessary for companies to once again begin increasing their fixed asset base, which could weigh significantly on free cash margin.

Fourteen industry sectors reported improved free cash margin from the same period in 2008, while no sectors saw free cash margin decline. Six sectors saw their free cash margin remain relatively stable. Individual companies examined in this report are XTO Energy (XTO), Target Corp. (TGT), Research in Motion (RIMM), Lions Gate Entertainment (LGF), Alkermes Inc. (ALKS), and Tele Norte Leste Participaco (TNE).

Data for this research were provided by Cash Flow Analytics, LLC., www.cashflowanalytics.com. Charles Mulford is a principal in Cash Flow Analytics, LLC. April, 2010

Georgia Tech Financial Analysis Lab
College of Management
Georgia Institute of Technology
Atlanta, GA 30332-0520

Georgia Tech Financial Analysis Lab

The Georgia Tech Financial Analysis Lab conducts research on issues of financial reporting and analysis. Unbiased information is vital to effective investment decision-making. Accordingly, we think that independent research organizations, such as our own, have an important role to play in providing information to market participants.

Because our Lab is housed within a university, all of our research reports have an educational quality, as they are designed to impart knowledge and understanding to those who read them. Our focus is on issues that we believe will be of interest to a large segment of stock market participants. Depending on the issue, we may focus our attention on individual companies, groups of companies, or on large segments of the market at large.

A recurring theme in our work is the identification of reporting practices that give investors a misleading signal, whether positive or negative, of corporate earning power. We define earning power as the ability to generate a sustainable stream of earnings that is backed by cash flow. Accordingly, our research may look into reporting practices that affect either earnings or cash flow, or both. At times, our research may look at stock prices generally, though from a fundamental and not technical point of view.

Contact Information

Charles Mulford	INVESCO Chair, Professor of Accounting and the Lab's Director Phone: (404) 894-4395 Email: charles.mulford@mgt.gatech.edu
Brandon Miller	Graduate Research Assistant and MBA Student
Andrew Parkhurst	Graduate Research Assistant and MBA Student
Website:	http://www.mgt.gatech.edu/finlab

Cash Flow Trends and Their Fundamental Drivers: Comprehensive Industry Review (Qtr 4, 2009)

Industries Identified in This Report (with GICS)

Companies Identified in This Report

Cash Flow Trends and Their Fundamental Drivers:
Comprehensive Industry Review (Qtr 4, 2009)

FREE CASH MARGIN INDEX*:

Recession Low (Mar. 2001, Dec. 2008)	Current (Dec. 2009)	Previous Expansion High (June, 2004)
2.43, 4.12	**6.56**	**5.14**

The ***Free Cash Margin Index** is free cash flow measured as a percentage of revenue for the trailing twelve month period.

Introduction

This research report is part of a continuing series that examines cash flow trends and the underlying drivers that are causing changes in those trends. In the current study we conduct a review of the cash flow performance of all U.S. non-financial companies for a series of rolling twelve-month periods from the first quarter of 2000 through the fourth quarter of 2009. Additionally, we look at individual industry results and focus our attention on the cash flow performance of several companies in those industries that stood out with improving free cash margin and in those that suffered from significant declines in free cash margin. All companies with a current market cap of $50 million or more are included, resulting in a total sample of 3,876 companies. Please see pages 6-8 for a list of industries and sub-industries included. That list is followed by a summary of our findings.

Measured as free cash flow divided by revenue, free cash margin is a cash flow profit margin. It indicates what percent of revenue is left for shareholders in the form of free and discretionary cash flow. If the company sells its products or services for a dollar, free cash margin tells us how many cents the shareholders can take home without reducing the company's ability to generate more. Thus, as we look at cash flow trends and their underlying drivers, our particular interest is on how those factors impact free cash margin.

For more detail, our industry spreadsheets that identify trends in free cash margin and its underlying drivers for 20 separate four-digit GICS industry sectors and 61 six-digit GICS industries for the all available reporting periods through the fourth Quarter of 2009 have been posted. The spreadsheets, which are updated quarterly, can be found on the Lab's website at www.mgt.gatech.edu/finlab.

Our Continuing Focus on Cash Flow

Corporate financial success is dependent not only on a company's ability to generate revenues and earnings, but also cash flow, especially free cash flow. It is free cash flow and growth in free cash flow, that discretionary stream of cash that a company can put to use for acquisitions, debt retirement, dividends and stock buybacks that works with growing earnings to drive firm value higher. Because it is "free," free cash flow comes with no strings attached. It is truly discretionary. Spending it does not impact the company's ability to generate more. A company with revenue growth will eventually lose the favor of investors if it never finds a way to generate earnings. In a similar way, a company with profits that is unable to generate cash will also experience waning investor enthusiasm. It may take a while. Investors are patient with profitable, growing companies. Ultimately, however, a company must show an ability to generate free cash flow.

Companies that consume cash must continually seek new sources of capital – whether debt or equity. At some point, those sources of capital will dry up or become prohibitively expensive if the firm does not show at least some progress toward getting closer to positive cash generation. Worse, if cash flow does not back a company's earnings, ultimately those earnings themselves may become suspect, necessitating write-downs of the resulting non-cash assets. Net losses will likely accompany those write-downs.

When free cash margin is positive, a firm is covering all ongoing claims and is able to pay dividends, reduce debt or simply add to its cash coffers. When free cash margin turns negative, ongoing claims are not being met. Cash and short-term investments can be used to meet the shortfall. However, on-hand cash and short-term investments are not an unlimited source of funds. Firms can borrow money to meet their needs. However, even if this were an option, increasing debt levels add new, unwanted risks. Equity issues provide another avenue, but capital markets can be painfully dilutive when share prices are depressed for firms that are seemingly unable to generate cash.

During periods of growth, firms may have problems generating cash as profits are consumed with growth-related investments in working capital and property, plant and equipment needed to support that growth. During recessions, cash generation can be particularly problematic as revenues and profits decline, draining the economic engine that supports cash generation. Regardless of the economic environment, however, free cash margin serves as an important measure of long-term financial health for individual companies, industries and the economy as a whole. We think that by periodically examining their cash generating ability, we will gain insight into the overall financial health of important segments of U.S. firms. With data dating back to 2000, we will see how the cash-generating performance of these firms presently compares with their performance during previous periods of economic contraction (e.g., 2001 and 2008-2009) and economic expansion.

Cash Flow Definitions

Free cash flow is the cash flow equivalent of the income statement “bottom line.” Like net income, free cash flow is available for shareholders after all prior claims have been satisfied. However, also like net income, which, to facilitate analysis, can be divided into certain sub-measures of performance, like gross profit and operating profit, free cash flow can be similarly divided. Thus, while our primary focus is on free cash flow and free cash margin, or free cash flow as a percentage of revenue, we analyze here the fundamental drivers underlying two distinct, but also closely related, measures of cash flow:

1) Operating cash flow and operating cash margin - cash flow from operations after interest charges and income taxes. Operating cash margin is operating cash flow divided by revenue.

2) Free cash flow and free cash margin - cash flow available for common shareholders that can be used for such discretionary purposes as stock buybacks and dividends without affecting the firm's ability to grow and generate more. This measure is calculated as operating cash flow less preferred dividends and net capital expenditures. Free cash margin is free cash flow divided by revenue.

Data and Methodology

Our data is provided by Cash Flow Analytics, LLC[1]. As noted, each data amount is for a rolling twelve-month period ending with the quarter end in question. For example, cash flow amounts for December 31, 2009 represent amounts for the twelve months (four quarters) ending December 31, 2009.

Industries

The 20 four-digit GICS industry sectors and 61 six-digit GICS sub-industries are as follows:

- **Energy – 1010**
- Energy Equipment & Services – 101010
- Oil, Gas & Consumable Fuels – 101020
- **Materials – 1510**
- Chemicals – 151010
- Construction Materials – 151020
- Containers & Packaging – 151030
- Metals & Mining – 151040
- Paper & Forest Products – 151050
- **Capital Goods – 2010**
- Aerospace & Defense – 201010
- Building Products – 201020
- Construction & Engineering – 201030

[1] Cash Flow Analytics, LLC, 1727 Malvern Place, Duluth, Georgia, 30097. www.cashflowanalytics.com. Charles Mulford is a principal in Cash Flow Analytics, LLC.

- Electrical Equipment – 201040
- Industrial Conglomerates – 201050
- Machinery – 201060
- Trading Companies & Distributors – 201070
- **Commercial & Professional Services – 2020**
- Commercial Services & Supplies – 202010
- Professional Services – 202020
- **Transportation – 2030**
- Air Freight & Logistics – 203010
- Airlines – 203020
- Marine – 203030
- Road & Rail – 203040
- Transportation Infrastructure – 203050
- **Automobiles & Components – 2510**
- Auto Components – 251010
- Automobiles – 251020
- **Consumer Durables & Apparel – 2520**
- Household Durables – 252010
- Leisure Equipment & Products – 252020
- Textiles, Apparel & Luxury Goods – 252030
- **Consumer Services – 2530**
- Hotels, Restaurants & Leisure – 253010
- Diversified Consumer Services – 253020
- **Media – 2540**
- Media – 254010
- **Retailing – 2550**
- Distributors – 255010
- Internet & Catalog Retail – 255020
- Multiline Retail – 255030
- Specialty Retail – 255040
- **Food & Staples Retailing – 3010**
- Food & Staples Retailing – 301010
- **Food Beverage & Tobacco – 3020**
- Beverages – 302010
- Food Products – 302020
- Tobacco – 302030
- **Household & Personal Products – 3030**
- Household Products – 303010
- Personal Products – 303020
- **Health Care Equipment & Services – 3510**
- Health Care Equipment & Supplies – 351010
- Health Care Providers & Services – 351020
- Health Care Technology – 351030
- **Pharmaceuticals, Biotechnology & Life Sciences – 3520**
- Biotechnology – 352010
- Pharmaceuticals – 352020
- Life Sciences Tools & Services – 352030

- **Software & Services – 4510**
- Internet Software & Services – 451010
- It Services – 451020
- Software – 451030
- **Technology Hardware & Equipment - 4520**
- Communications Equipment – 452010
- Computers & Peripherals – 452020
- Electronic Equipment, Instruments & Components – 452030
- Office Electronics – 452040
- Semiconductor Equipment & Products – 452050
- **Semiconductors & Semiconductor Equipment – 4530**
- Semiconductors & Semiconductor Equipment – 453010
- **Telecommunication Services – 5010**
- Diversified Telecommunication Services – 501010
- Wireless Telecommunication Services – 501020
- **Utilities – 5510**
- Electric Utilities – 551010
- Gas Utilities – 551020
- Multi-utilities – 551030
- Water Utilities – 551040
- Independent Power Producers & Energy Traders – 551050

Results

Summary

Despite declining revenues, free cash margin improved during the four quarters ended December 2009 to 6.56%, the highest recorded reading since we began collecting data in March 2000. That measure is up from 5.36% for the four quarters ending September 2009. Driving the increase in free cash margin were improvements in gross margin and a reduction in capital expenditures as a percent of revenue, offset by an increase in the cash cycle, caused by an increase in inventories and receivables. Companies have now reduced capital spending each quarter since March 2008. For the four quarters ending December 2009, capital spending as a percent of revenue stood at a recession low of 2.82%, down from 3.02% in the period ended September 2009. Our expectation is that as the economy grows, it will be necessary for companies to once again begin increasing their fixed asset base, which could weigh significantly on free cash margin.

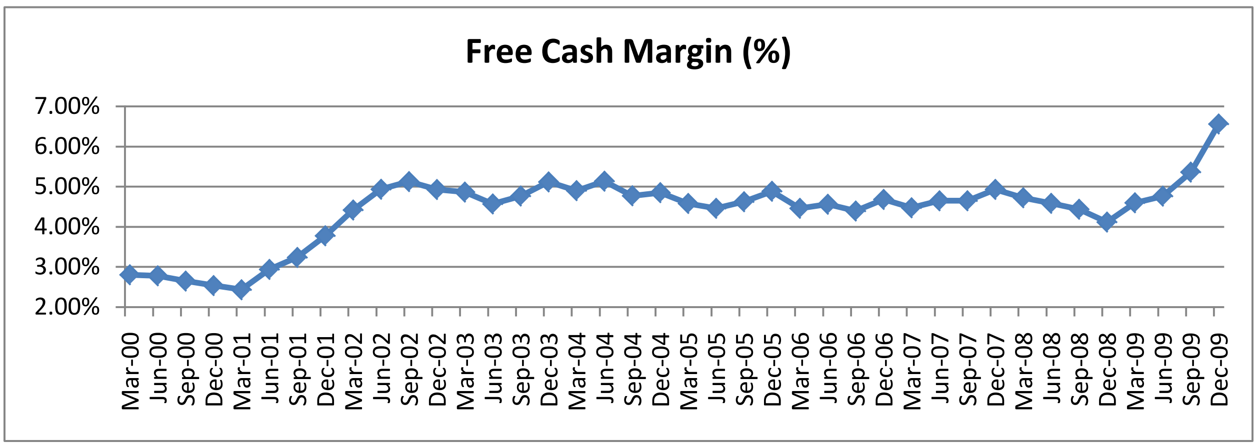
Results for all non-financial companies

In the exhibits below we present a graph of free cash margin and several of its underlying drivers. These exhibits were constructed with data from our complete sample of companies, including all industries and sub-industries. A total of 3,876 companies are included. These graphs are followed with exhibits that show the trend in free cash margin for each of the 20 industry groups. For more details on each individual industry, please refer to the individual industry spreadsheets reports that are available on our website (www.mgt.gatech.edu/finlab).

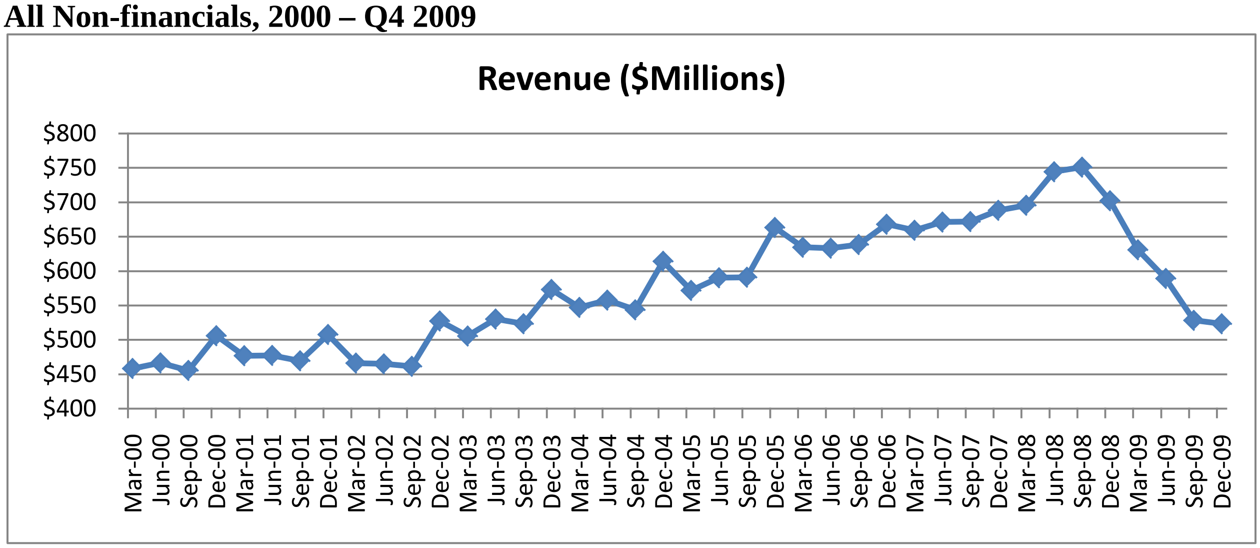
Free cash margin continued its recent ascent in the 4th quarter of 2009. With free cash margin at 6.56%, it is up significantly from the 5.36% recorded last quarter and is currently at the highest level recorded since our lab began tracking the metric in 2000. Despite declining revenues, since reaching a low of 4.12% in December 2008, free cash margin has improved every quarter since then. In order to offset the effects on free cash flow of declining revenues, companies may improve profitability or reduce capital expenditures. Companies in our sample did both during the four quarters ending December 2009.

During the December 2009 reporting period, median operating cash flow increased to $59,903,000 from $54,598,000 in the period ended September 30, 2009. This is the first 'up-tick' in operating cash flow we have seen since September 2008. Free cash flow continued the upward trend begun in 2009. Since reaching a recession low of $14,249,000 in the four quarters ending December 2008, median free cash flow has now increased every quarter and stood at $25,779,000 for the four quarters ending December 2009.

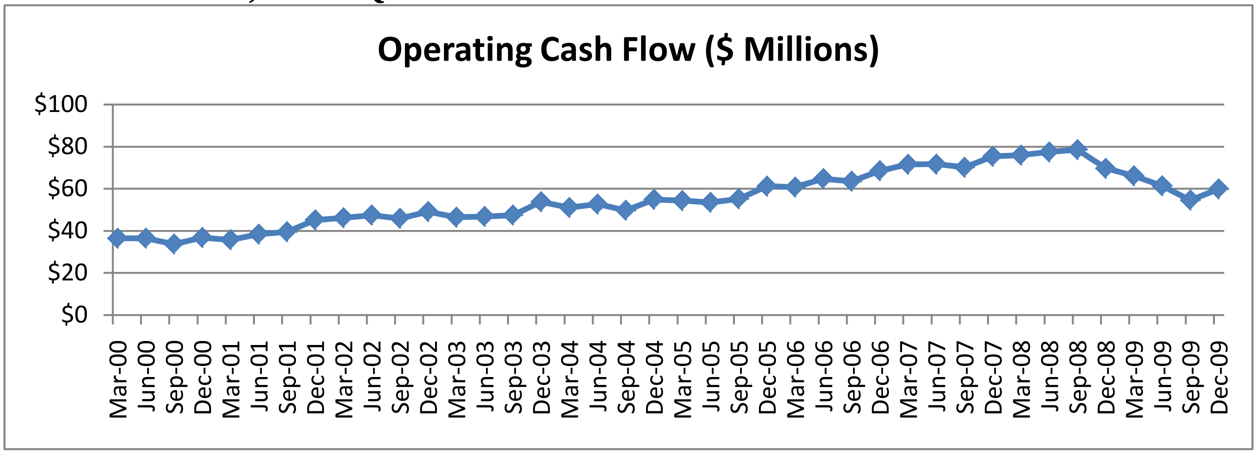
All Non-financials, 2000 – Q4 2009



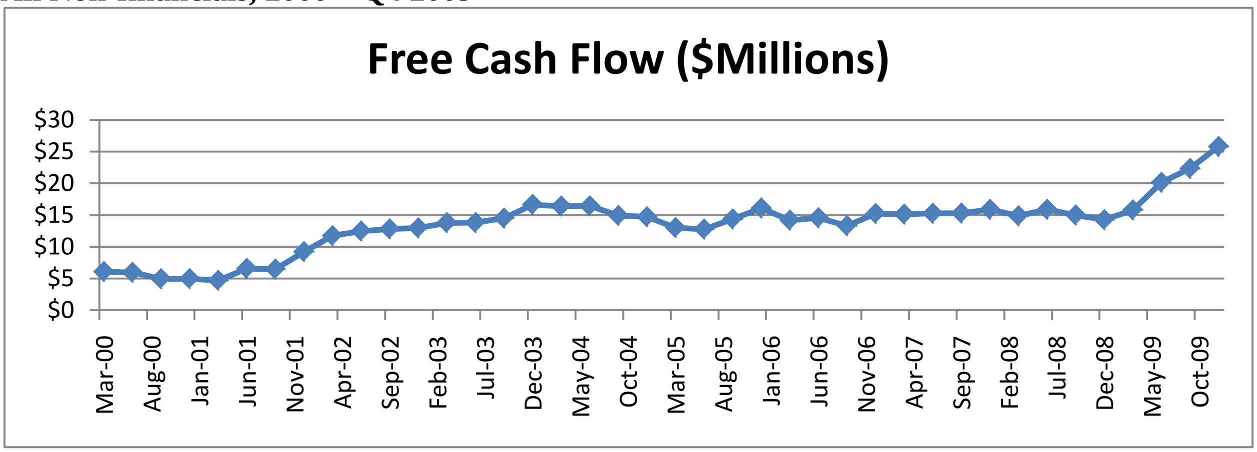
All Non-financials, 2000 – Q4 2009



All Non-financials, 2000 – Q4 2009



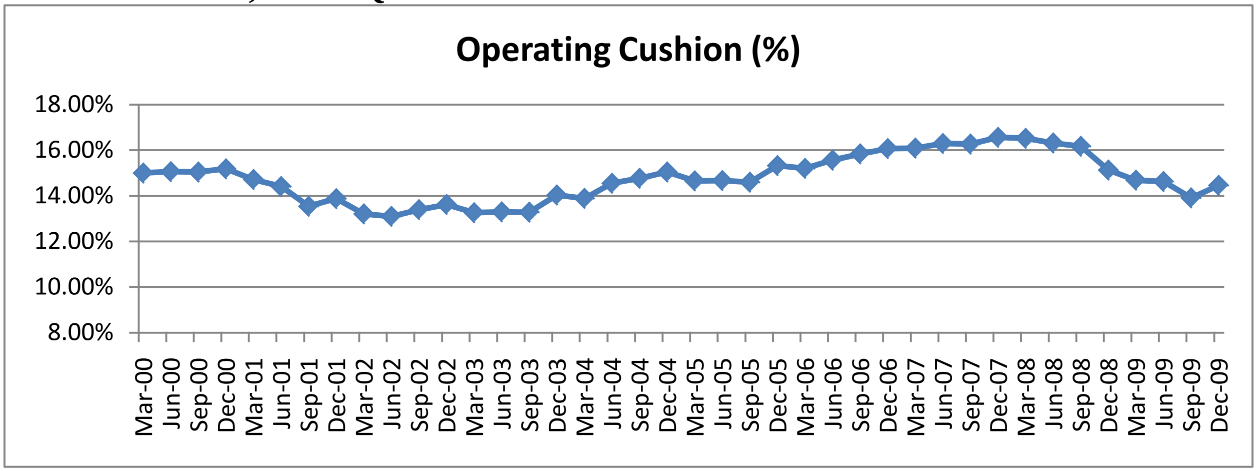
All Non-financials, 2000 – Q4 2009



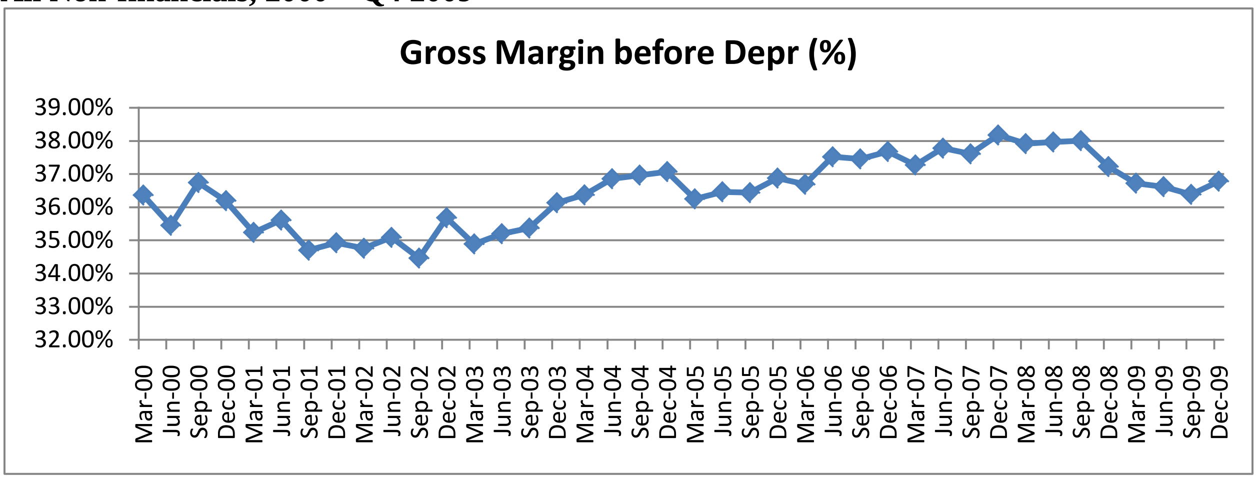
Fueling the Q4 2009 improvements in free cash margin have been changes in operating cushion, capital expenditures as a percentage of revenue, and income taxes paid.

Operating cushion, or operating profit before depreciation and amortization, increased slightly, helped by improving gross margin and declining SG&A expenditures as a % of revenue. It is noteworthy that sample firms were able to improve operating cushion even with declining revenues. Managers are doing an excellent job of controlling costs and improving efficiency. As the U.S. economy once again begins to grow, these companies should be poised to boost profitability and operating cushion further.

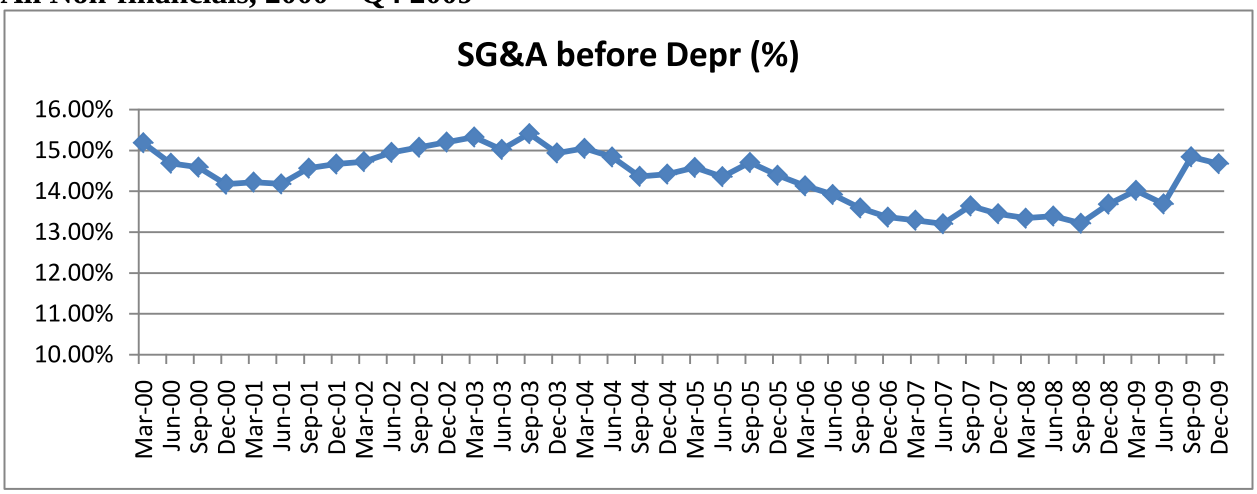
All Non-financials, 2000 – Q4 2009



All Non-financials, 2000 – Q4 2009

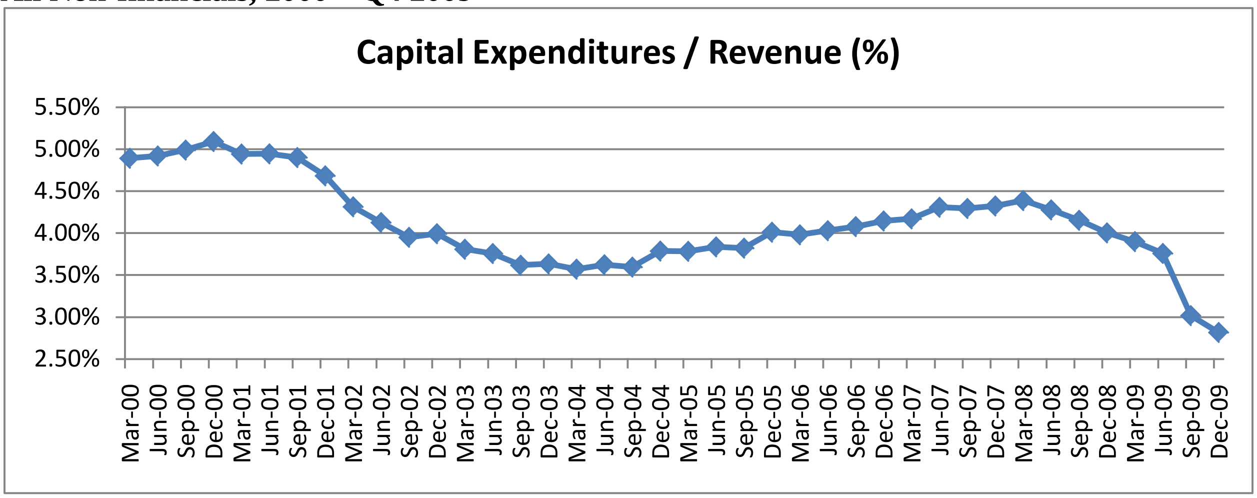


All Non-financials, 2000 – Q4 2009



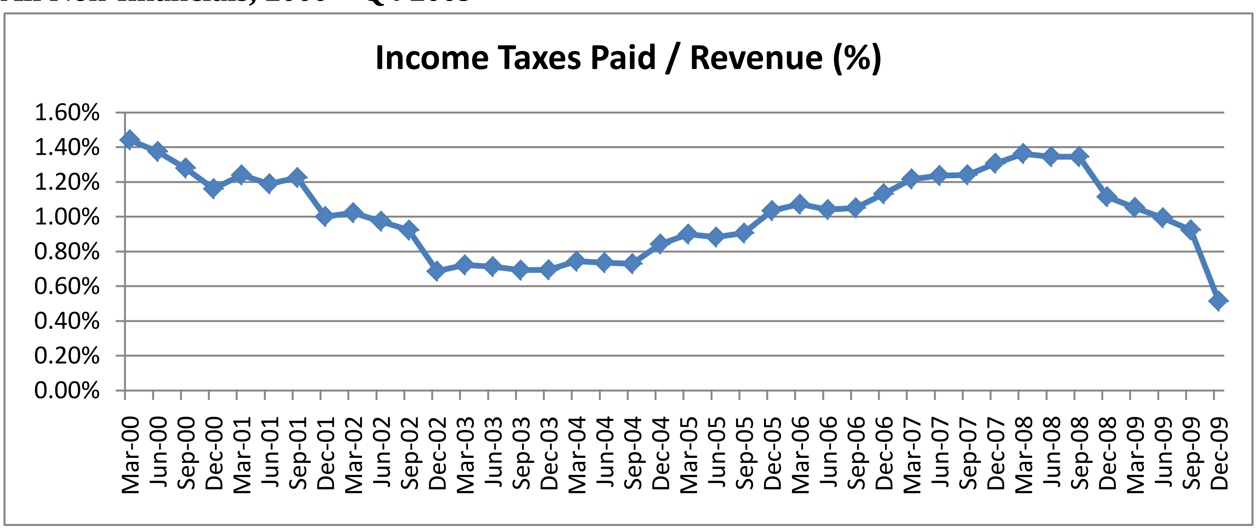
Capital expenditures as a % of revenue declined in the four quarters ending December 2009. After peaking in March 2008 at 4.39% of revenue, capital expenditures have declined each period since and were 2.82% in December 2009. While this marked decline in capital expenditures has boosted free cash margin, at some point companies will find it necessary to once again increase capital spending, which will weigh on free cash margin.

All Non-financials, 2000 – Q4 2009



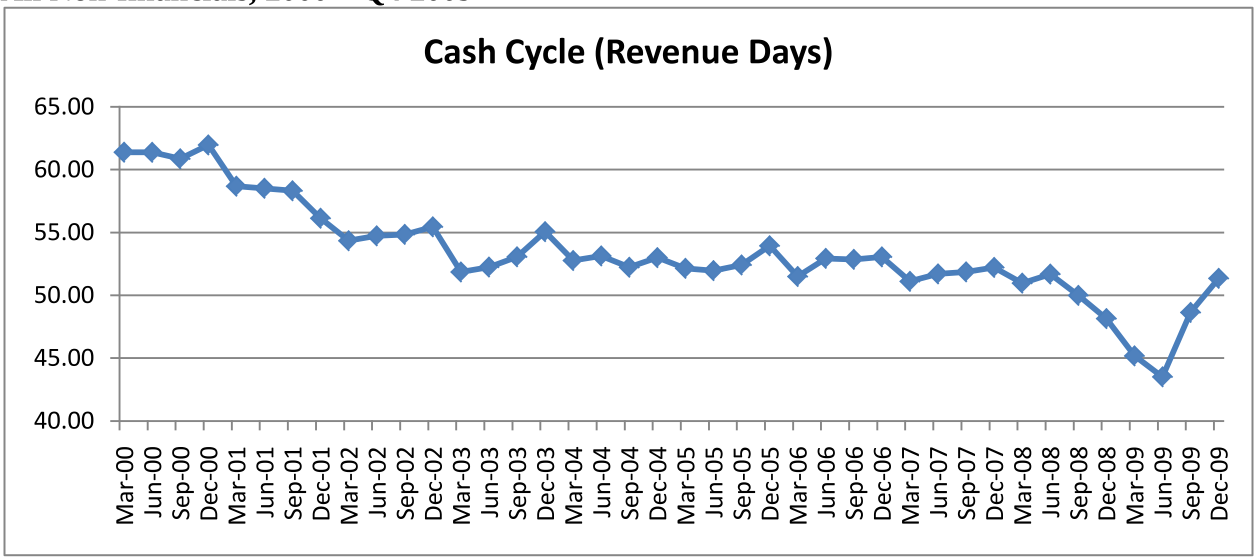
Income taxes paid to revenue fell from 0.92% in September 2009 to 0.52% in December 2009.

All Non-financials, 2000 – Q4 2009

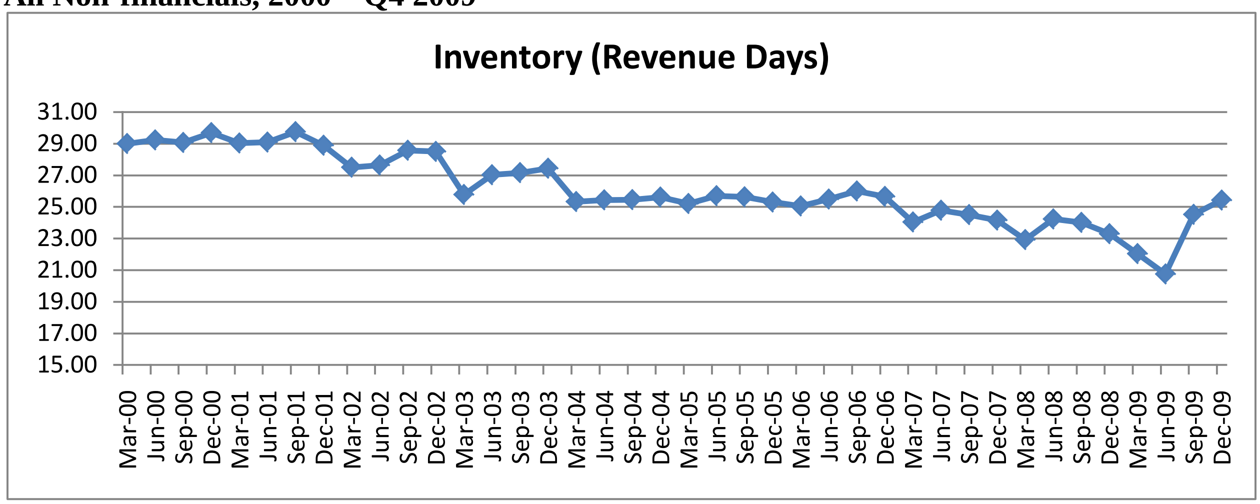


The cash cycle, which measures the proportion of operating cash flow carried in working capital and is measured receivables days plus inventory days less payables days, increased during the four quarters ending December 2009. Driving the increase in the cash cycle was an increase in median inventory days to 25.43 days in December 2009 from 24.52 days in September 2009 and an increase in receivables days to 52.46 days in December 2009 from 50.23 in September 2009, offset somewhat by an increase in payables days to 26.54 days in December 2009 from 26.11 days in September 2009. The increase in the cash cycle is putting some downward pressure on free cash margin. This trend is likely to continue as companies replace inventories and grow receivables that were reduced during the recession.

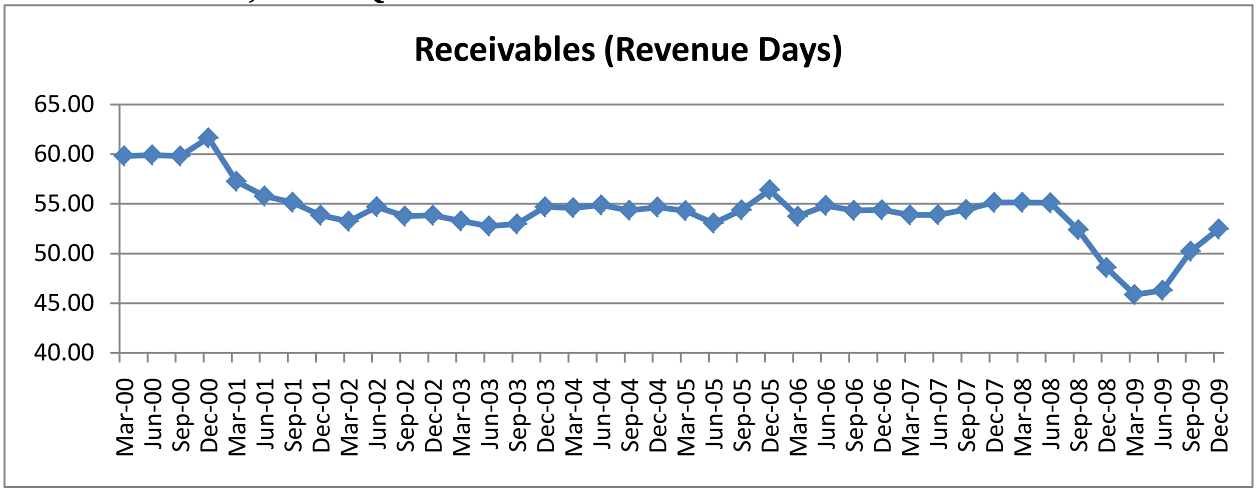
All Non-financials, 2000 – Q4 2009



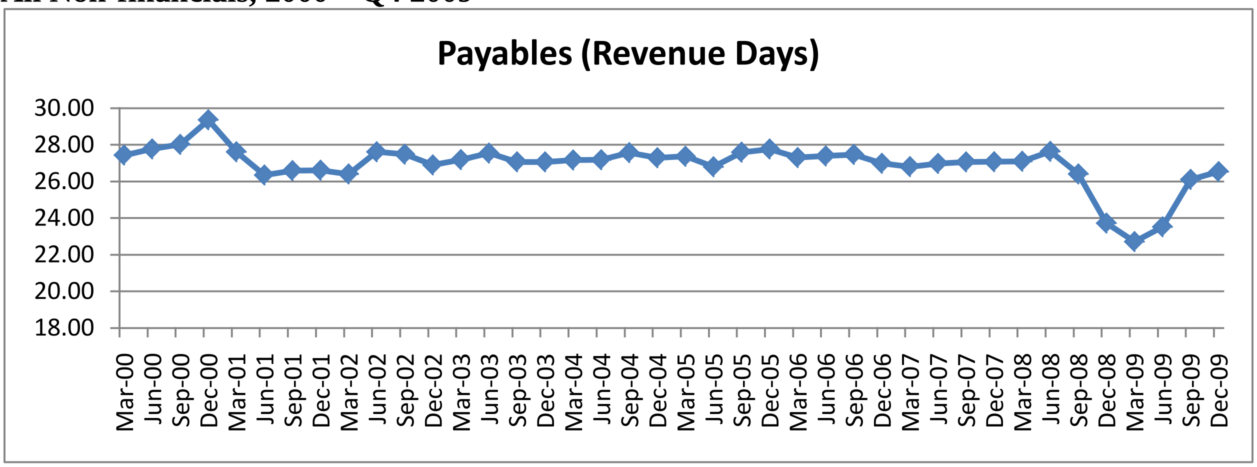
All Non-financials, 2000 – Q4 2009



All Non-financials, 2000 – Q4 2009



All Non-financials, 2000 – Q4 2009



Individual Industry Results

In observing the individual industry trends in free cash margin, the increases seen in the sample-wide data have also shown up across most industries studied. Of the 20 four-digit GICS industry sectors studied, during the twelve months ended December 2009 when compared with the twelve months ended December 2008, we saw moderate to substantial improvement in free cash margin in fourteen industries, relatively stable free cash margin in six industries, and we did not see any industries with declining free cash margin.

Industry sectors with improving free cash margin:

Energy (GICS 1010)
Materials (GICS 1510)
Capital Goods (GICS 2010)
Commercial and Professional Services (GICS 2020)
Automobiles and Components (GICS 2510)
Consumer Durables and Apparel (GICS 2520)
Consumer Services (GICS 2530)

Retailing (GICS 2550)
Food and Staples Retailing (GICS 3010)
Food, Beverage and Tobacco (GICS 3020)
Household and Personal Products (GICS 3030)
Sofware and Services (GICS 4510)
Technology Hardware and Equipment (GICS 4520)
Utilities (GICS 5510)

Industry sectors with stable free cash margin:

Transporation (GICS 2030)
Media (GICS 2540)
Healthcare Equipment and Services (GICS 3510)
Pharmaceuticals, Biotechnology and Life Sciences (GICS 3520)
Semiconductors and Semiconductor Equipment (GICS 4530)
Telecommunications Services (GICS 5010)

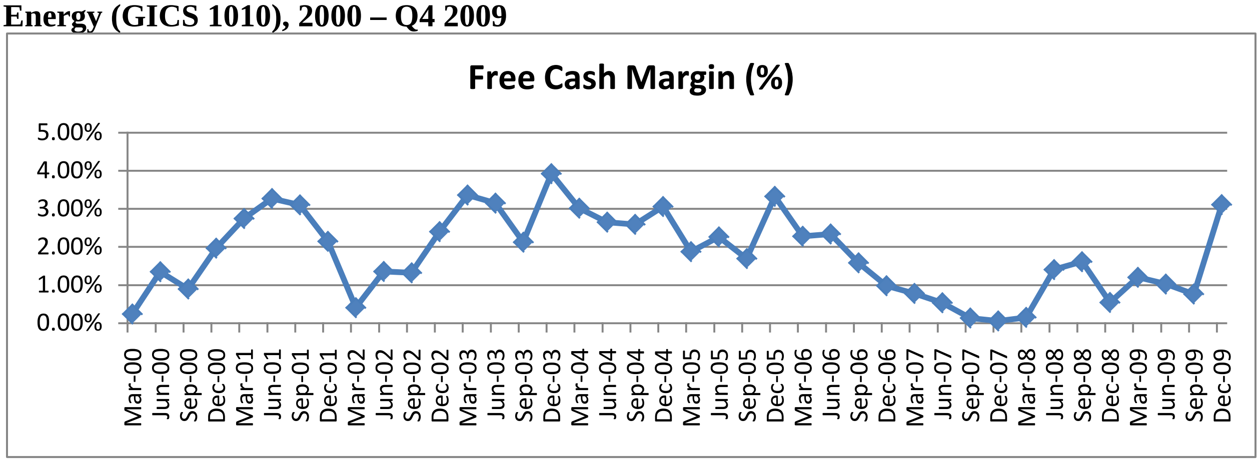
Industry sectors with declining free cash margin:

None

Please refer to the individual industry spreadsheets, available on our website, for further detail on the industries discussed in this report.

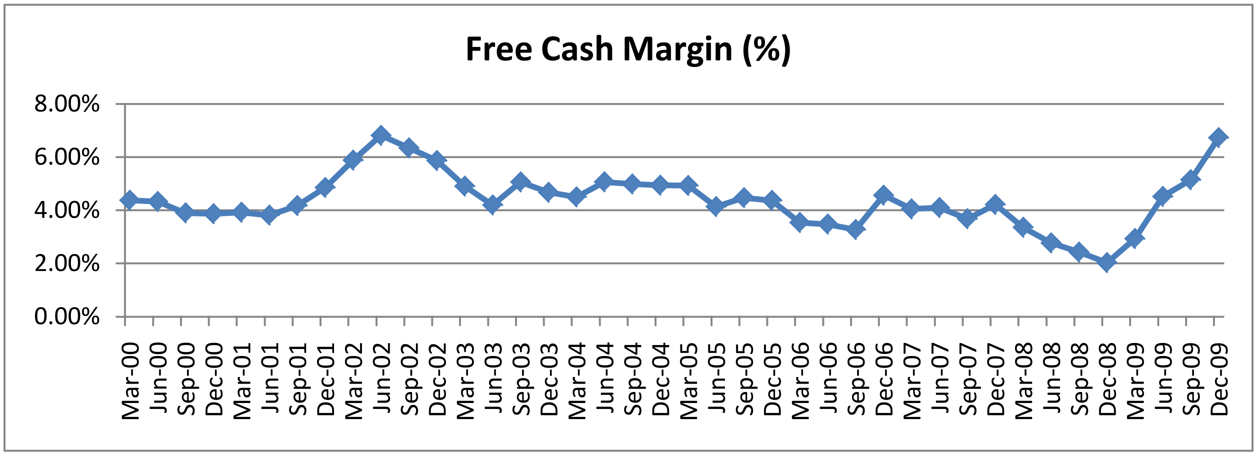
Our results show the following trends in free cash margin:

Energy (GICS 1010), 2000 – Q4 2009



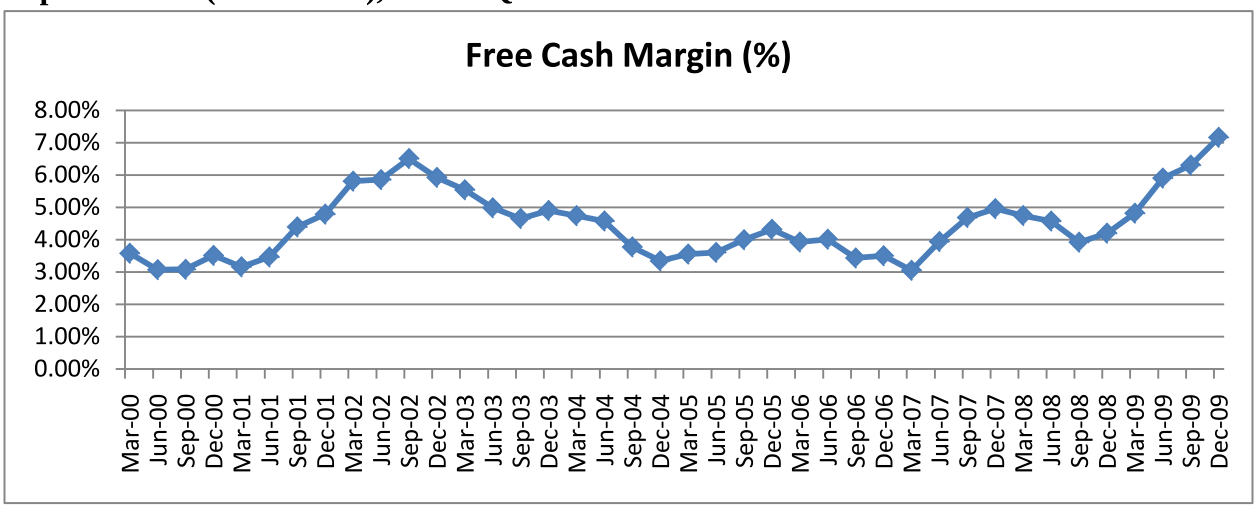
See industry specific spreadsheet for details.

Materials (GICS 1510), 2000 – Q4 2009



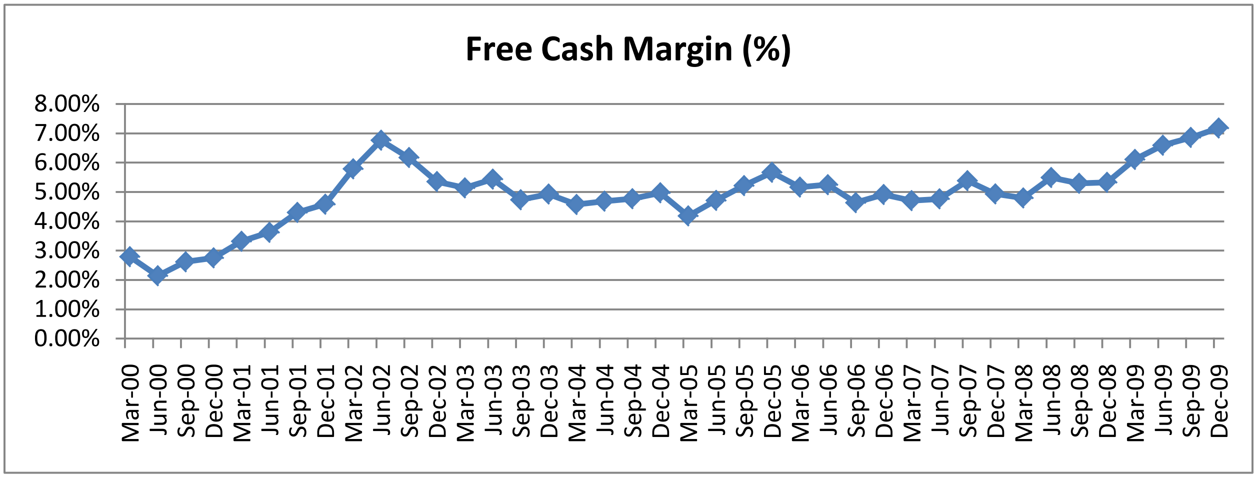
See industry specific spreadsheet for details.

Capital Goods (GICS 2010), 2000 – Q4 2009



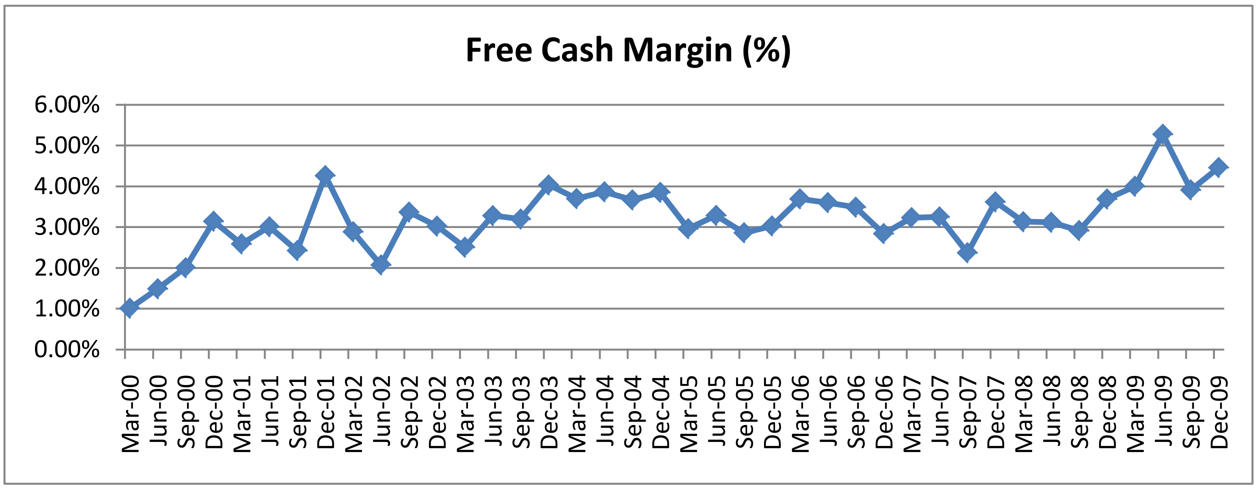
See industry specific spreadsheet for details.

Commercial and Professional Services (GICS 2020), 2000 – Q4 2009



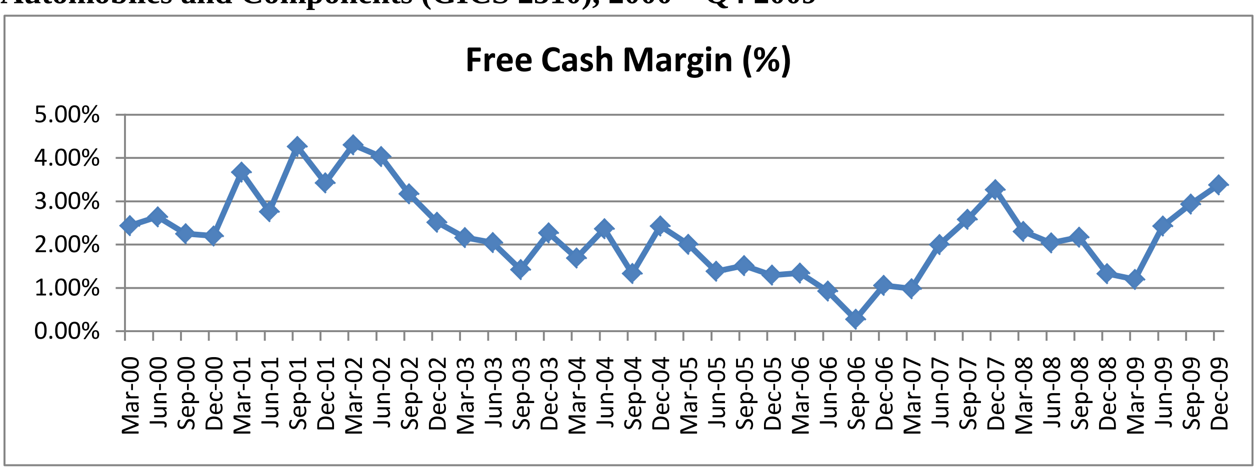
See industry specific spreadsheet for details.

Transporation (GICS 2030), 2000 – Q4 2009



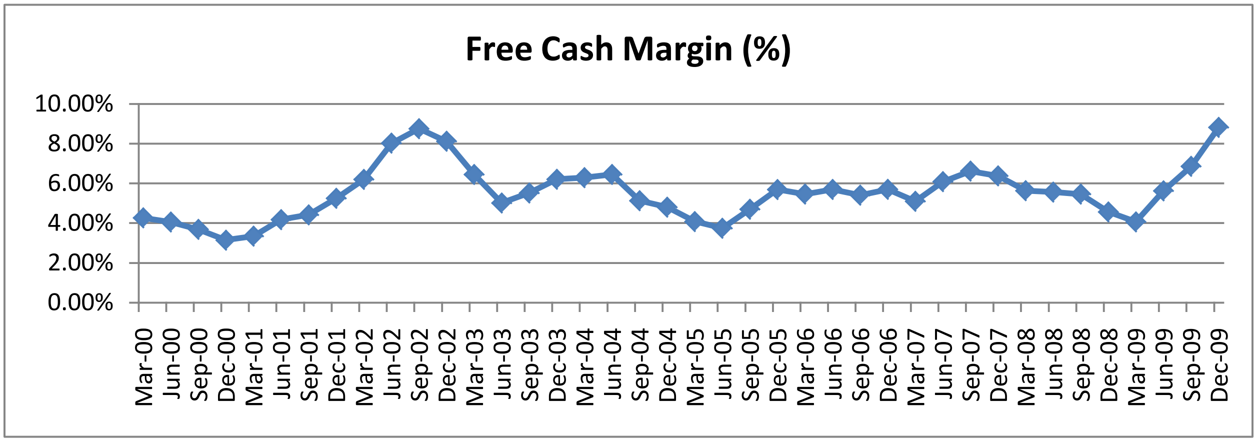
See industry specific spreadsheet for details.

Automobiles and Components (GICS 2510), 2000 – Q4 2009



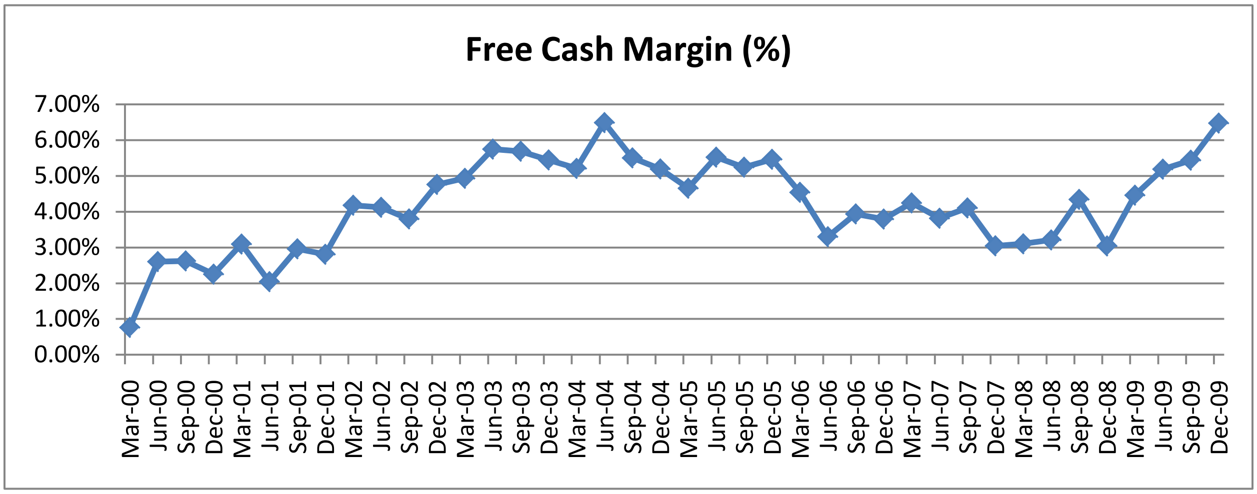
See industry specific spreadsheet for details.

Consumer Durables and Apparel (GICS 2520), 2000 – Q4 2009



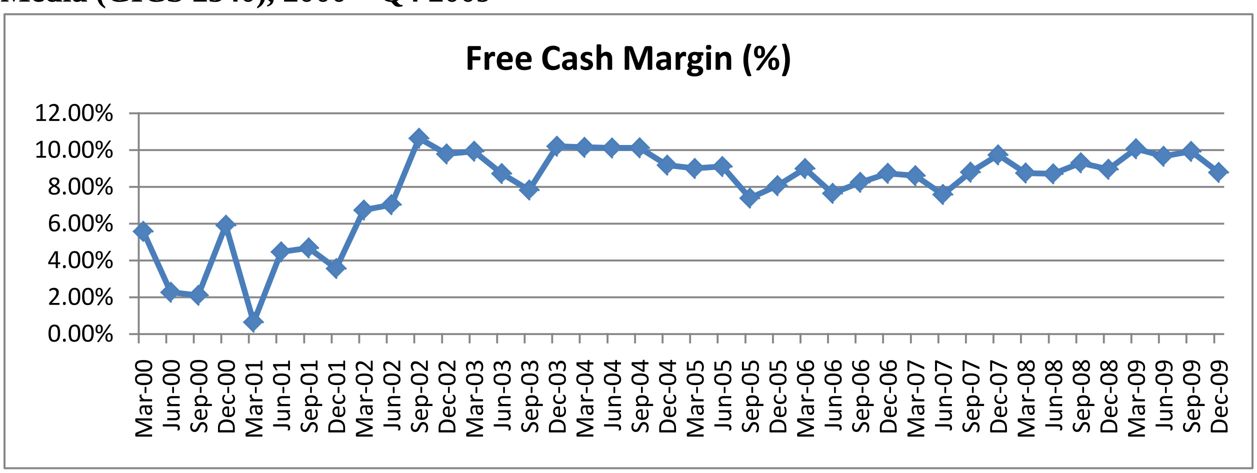
See industry specific spreadsheet for details.

Consumer Services (GICS 2530), 2000 – Q4 2009



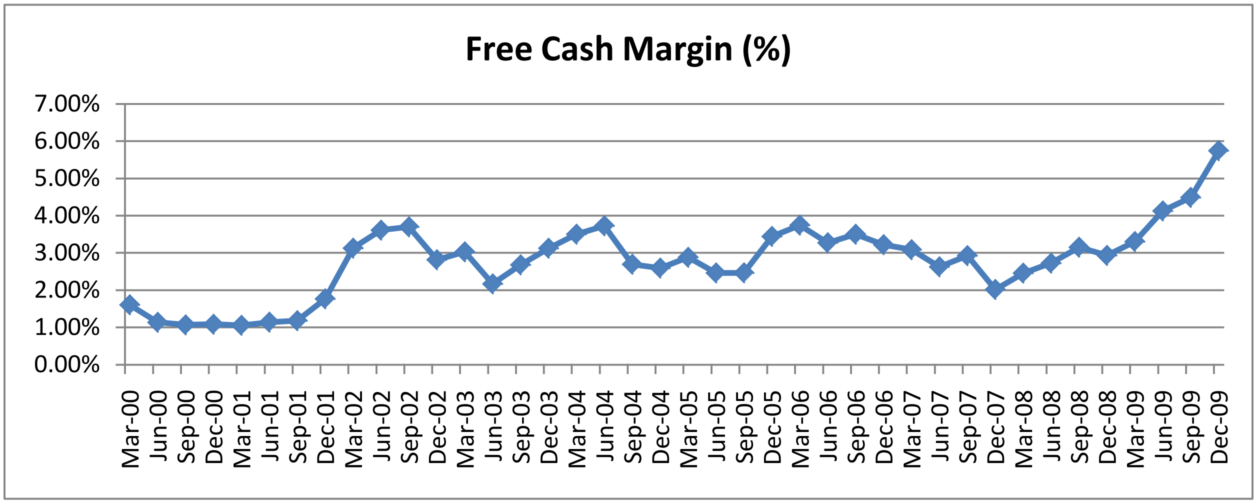
See industry specific spreadsheet for details.

Media (GICS 2540), 2000 – Q4 2009



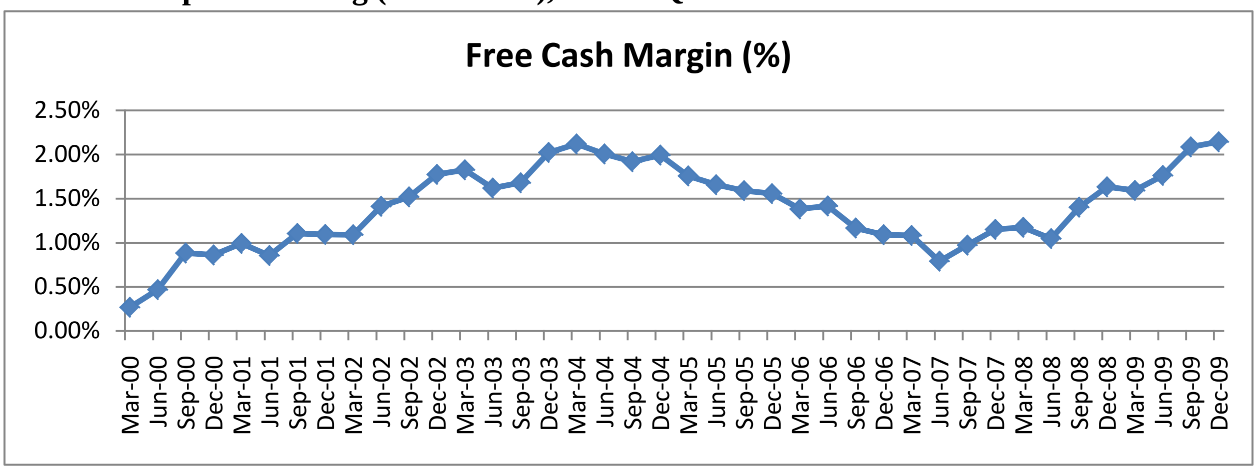
See industry specific spreadsheet for details.

Retailing (GICS 2550), 2000 – Q4 2009



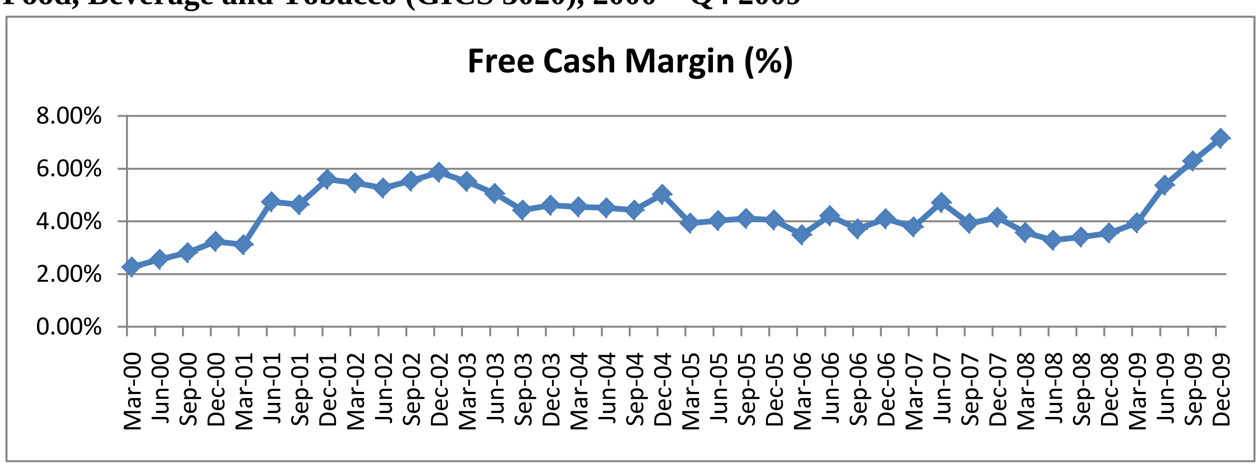
See industry specific spreadsheet for details.

Food and Staples Retailing (GICS 3010), 2000 – Q4 2009



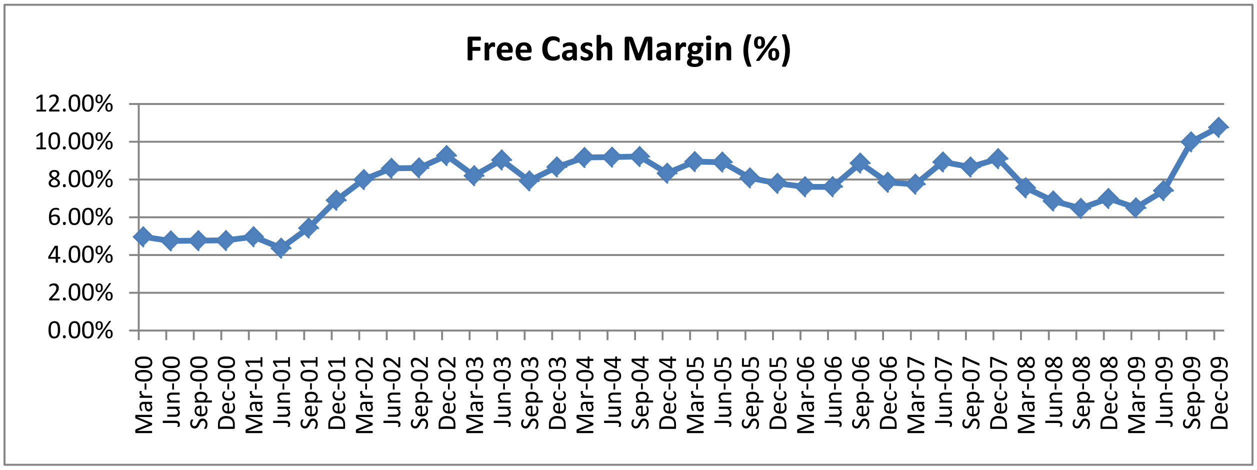
See industry specific spreadsheet for details.

Food, Beverage and Tobacco (GICS 3020), 2000 – Q4 2009



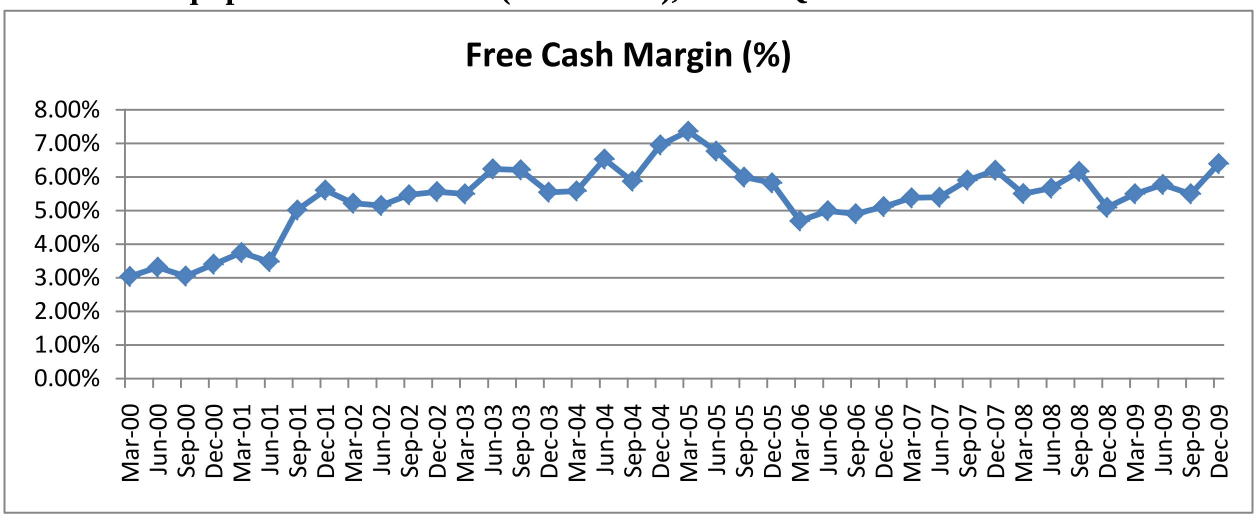
See industry specific spreadsheet for details.

Household and Personal Products (GICS 3030), 2000 – Q4 2009



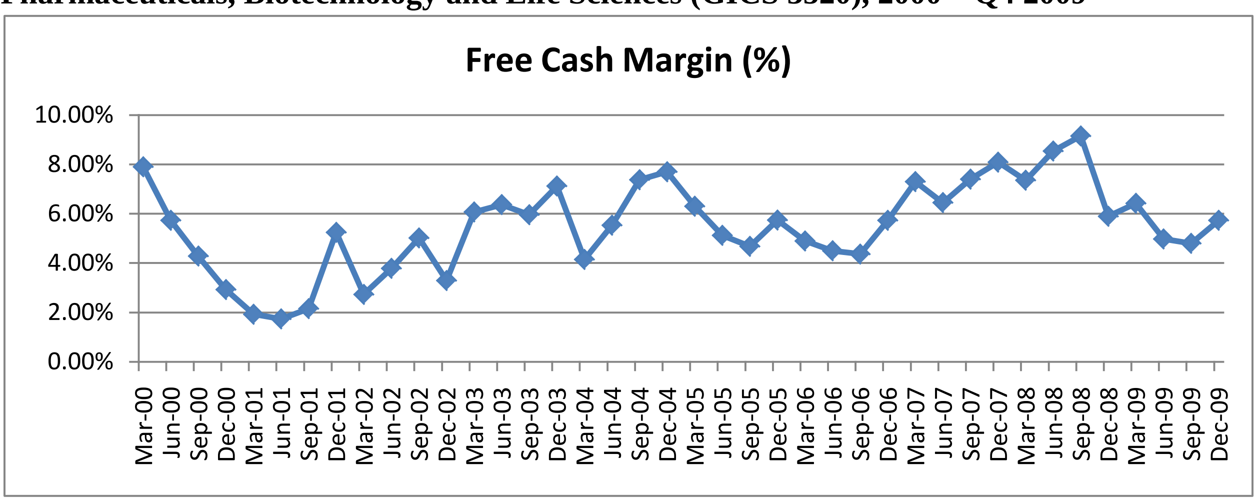
See industry specific spreadsheet for details.

Healthcare Equipment and Services (GICS 3510), 2000 – Q4 2009



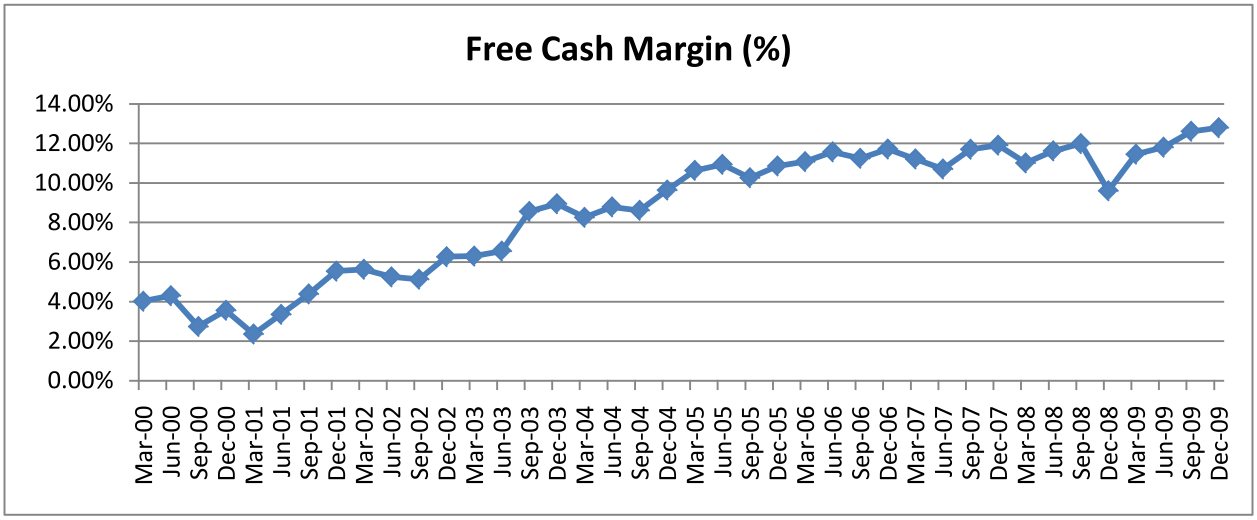
See industry specific spreadsheet for details.

Pharmaceuticals, Biotechnology and Life Sciences (GICS 3520), 2000 – Q4 2009



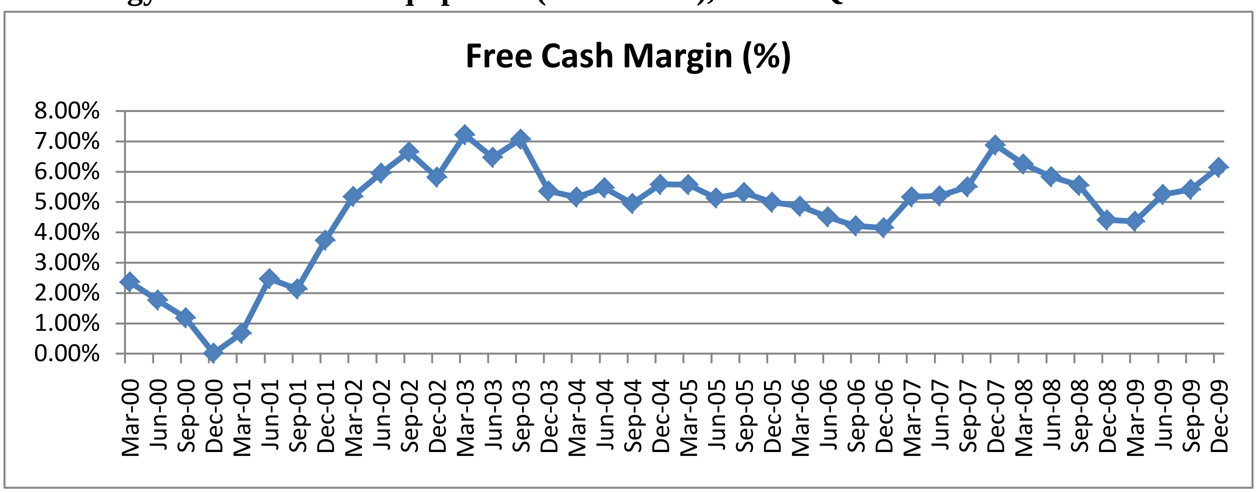
See industry specific spreadsheet for details.

Sofware and Services (GICS 4510), 2000 – Q4 2009



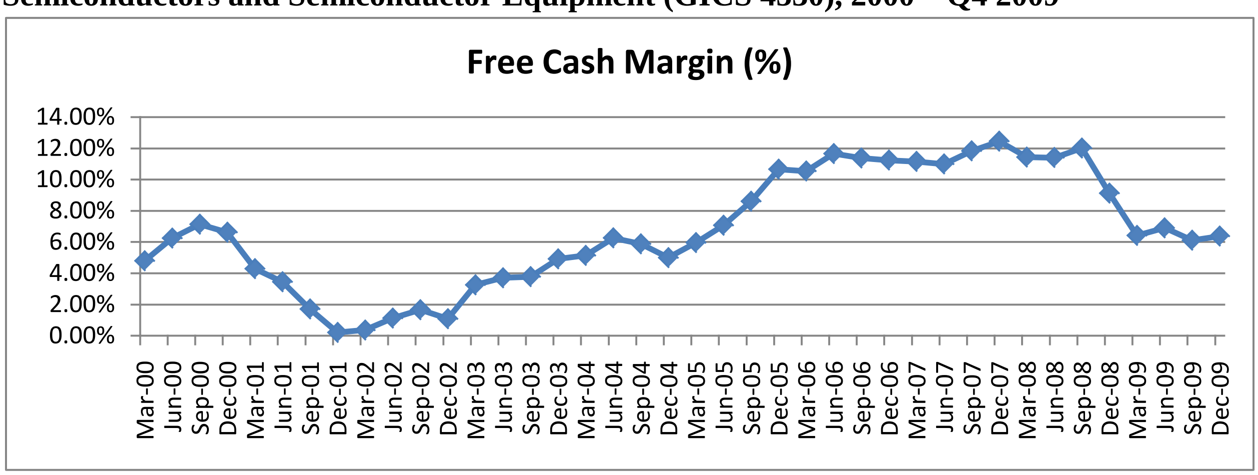
See industry specific spreadsheet for details.

Technology Hardware and Equipment (GICS 4520), 2000 – Q4 2009



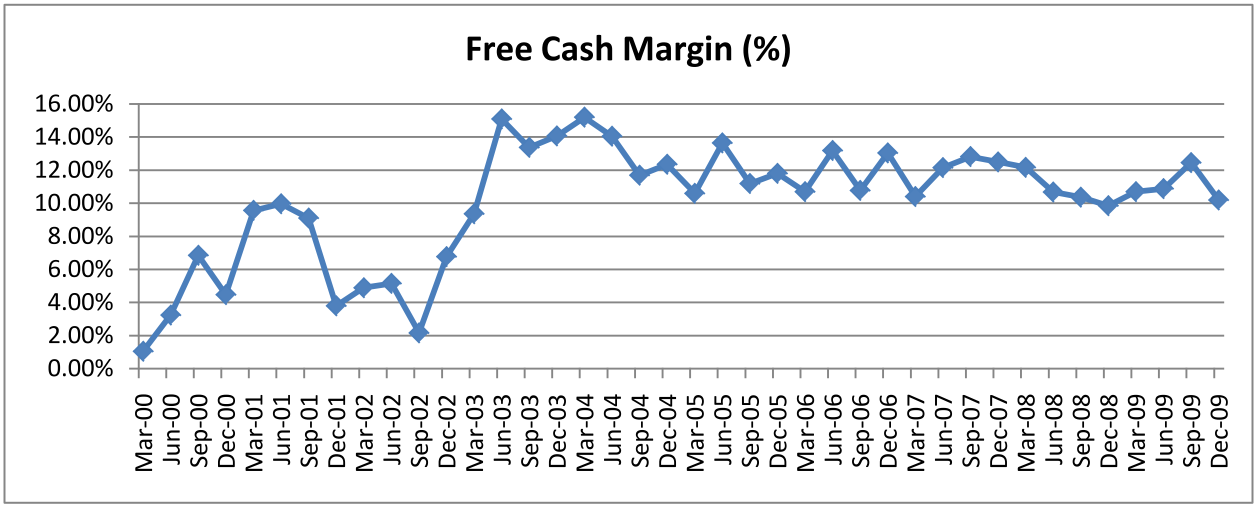
See industry specific spreadsheet for details.

Semiconductors and Semiconductor Equipment (GICS 4530), 2000 – Q4 2009



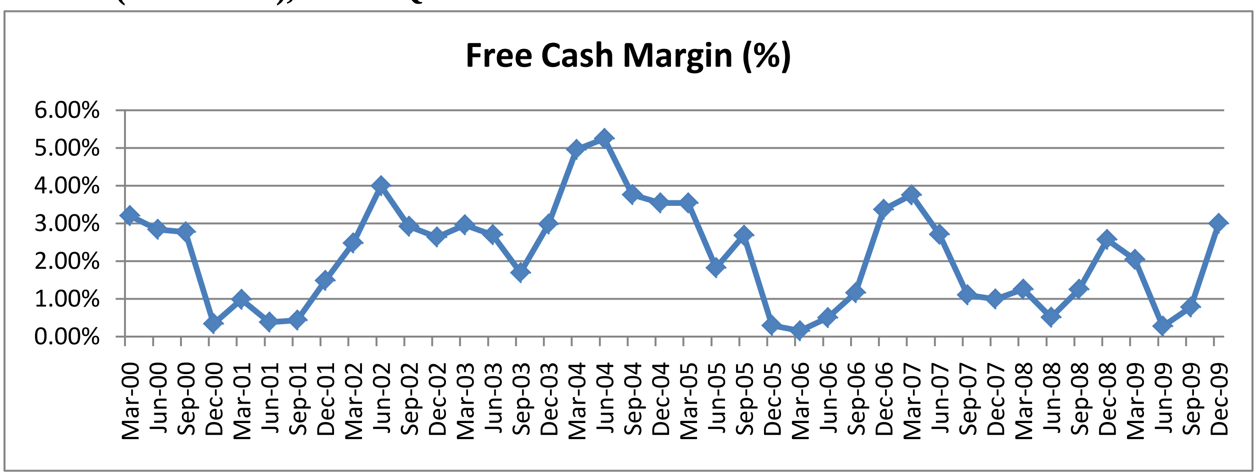
See industry specific spreadsheet for details.

Telecommunications Services (GICS 5010), 2000 – Q4 2009



See industry specific spreadsheet for details.

Utilities (GICS 5510), 2000 – Q4 2009



See industry specific spreadsheet for details.

The Standouts: A Closer Look

The drivers of improvements or declines in free cash margin consist of factors that impact profitability and efficiency. On the profitability front, operating cushion measures operating profit, exclusive of the non-cash expenses, depreciation and amortization. Factors impacting operating cushion consist of gross margin (excluding depreciation and amortization), and SG&A% (excluding depreciation and amortization). Also impacting profitability and a firm's ability to generate free cash flow, but excluded from operating cushion, is income taxes paid, which we measure as a percent of revenue. Capital expenditures do not impact profitability directly, but through depreciation. However, these expenditures are subtracted in computing free cash flow. It is also important to look at capital expenditures because these are investments in fixed assets that will likely improve a company's ability to generate revenue, and subsequent profit, in the future. Like operating expenses and taxes, we measure capital expenditures as a percent of revenue.

On the efficiency front, increases in receivables and inventory consume free cash flow. Increases in accounts payable provide free cash flow. The combination of receivables days plus inventory days less payables days is a firm's cash cycle. Reductions in the cash cycle provide free cash flow, while increases in the cash cycle consume free cash flow. We give consideration to all of these factors when analyzing changes in free cash margin for the standout firms discussed in this section.

Improving free cash margin

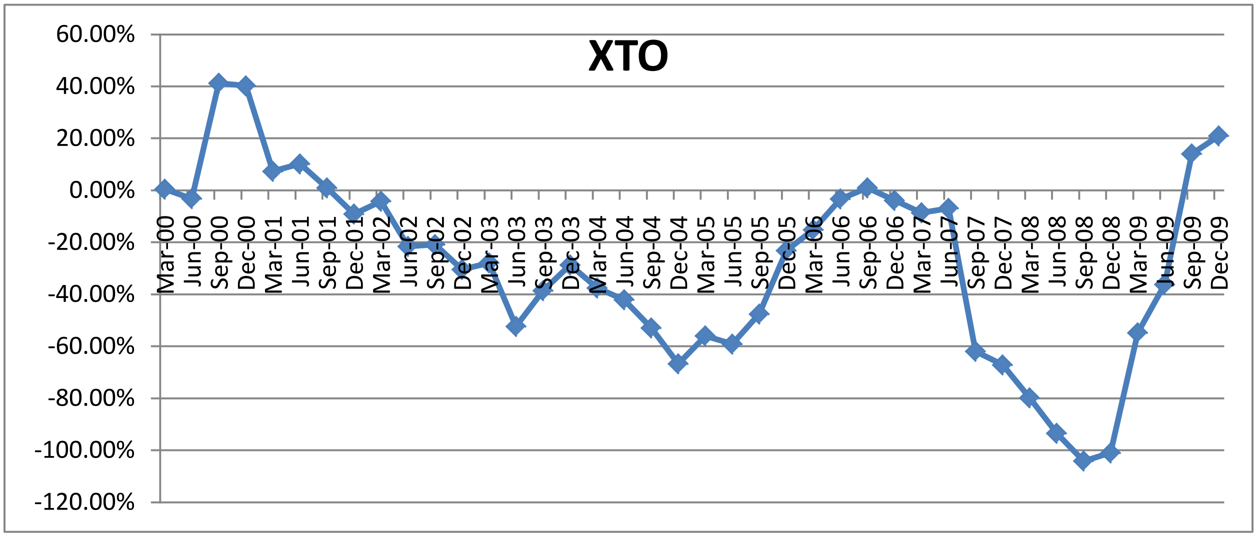
Among the industry sectors with improving free cash margin, there are three groups that stand out. The first is the Energy industry sector (GICS 1010). For this group, free cash margin improved to 3.11% for the twelve months ended December 2009, up from 0.54 % in December 2008. One company in this industry that showed particular improvement is XTO Energy Inc. (XTO).

Second, we saw improving fortunes in the Retailing industry sector (GICS 2550), where free cash margin increased to 5.75% for the twelve months ended December 2009 from 2.93% for the twelve months ended December 2008. A representative company from this group is Target Corp. (TGT).

Finally, free cash margin for the Technology and Hardware industry sector (GICS: 4520) improved to 6.14 % for the twelve months ending December 2009 from 4.41% in December 2008. We will take a closer look at Research in Motion's (RIMM) notable increase in free cash margin.

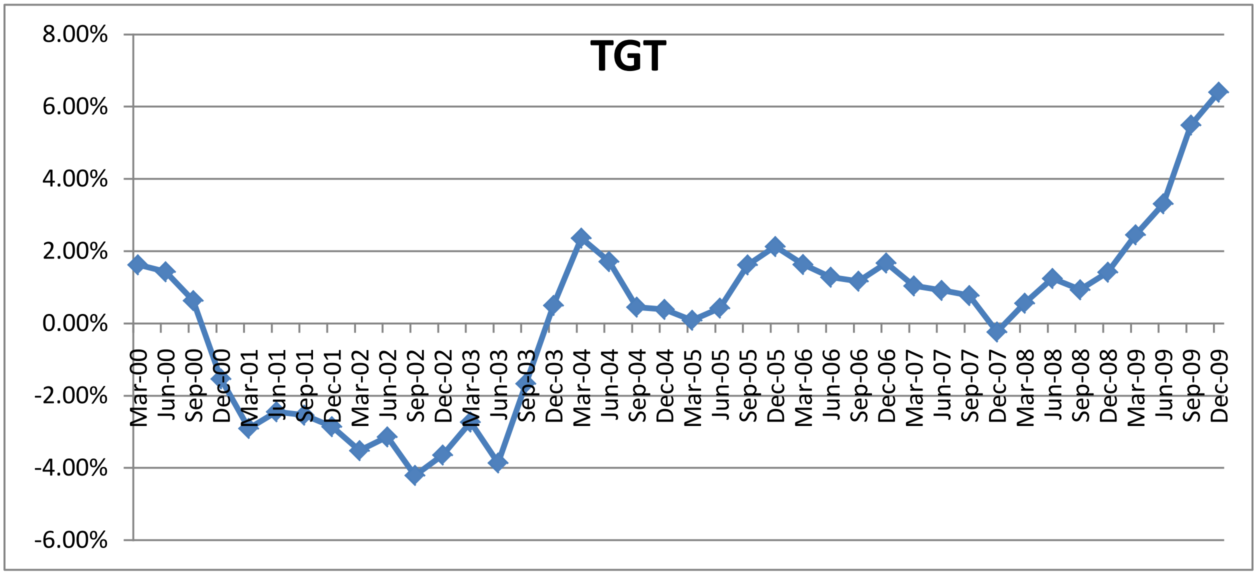
Graphs of free cash margin for these companies across the period studied are provided below. With each graph we also provide a short summary of the primary drivers or factors that we think were behind the observed changes in free cash margin for the selected firms. For more details regarding the industries, please refer to the separate industry spreadsheets found on our website.

XTO Energy Inc, Free Cash Margin, March 2000 – December 2009



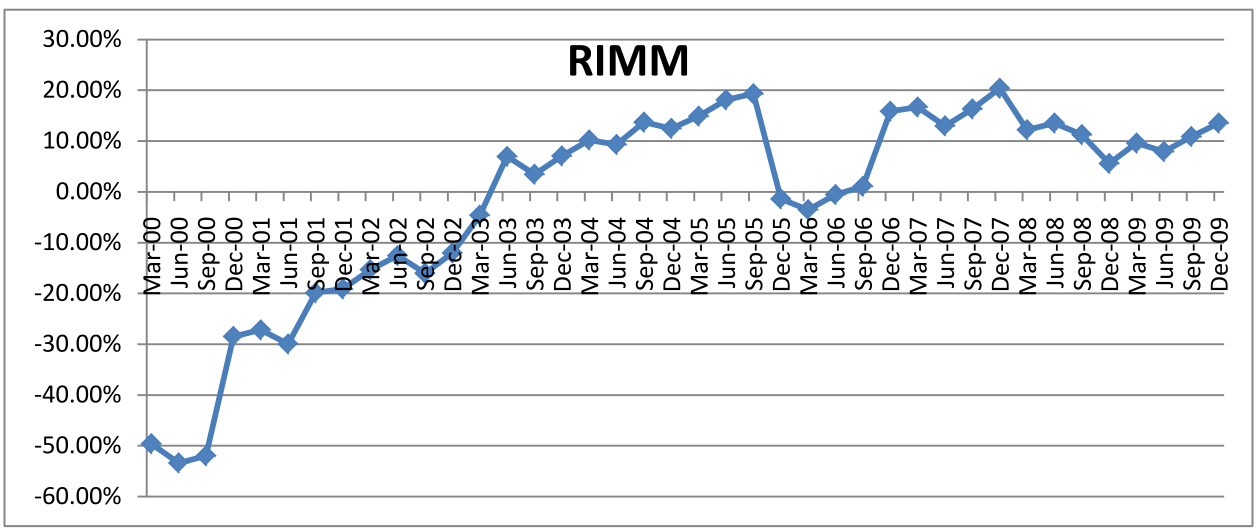
<u>XTO Energy Inc. (XTO)</u>. Free cash margin improved to 21% for the twelve months ended December 2009 from -101% for the twelve months ended December 2008. A significant decline in capital expenditures over the last year is the main driver of recent surge in XTO's free cash margin. Capital expenditures as a percent of revenue declined from 168.9% for the twelve months ending December 2008 to 44.82% for the same period ending December 2009. As stated in previous reports, we feel that reductions in capital spending do not provide for a sustainable source of improvement in free cash margin. A smaller driver of free cash margin was an increase in operating cushion to 76.83% in December 2009 from 73.45% in December 2008. XTO's operating cushion has been very consistent over the past 5 years, holding between 73% and 77%. Additionally, an increase in the cash cycle, driven by a decline in payables days from 90.73 days in 2008 to 59.76 days in 2009, accompanied by a decline in receivables days, from 57.75 days in 2008 to 38.91 days in 2009, put some upward downward pressure on free cash margin.

Target Corp., Free Cash Margin, December 2000 – December 2009



Target Corp. (TGT). Target's free cash margin improved to 6.40% for the twelve months ended December 2009 from 1.42% for the twelve months ended December 2008. A decrease in capital expenditures as a % of revenue, an increase in operating cushion, and a decrease in the cash cycle drove the improvement. Capital expenditures as a % of revenue decreased from 5.40% in December 2008 to 2.60% in December 2009, while operating cushion increased from 9.70% in December 2008 to 10.40% in December 2009. What the data indicate is that Target has been able to decrease capital expenditures and increase operating cushion as their revenues have remained flat. Additionally, Target reduced its cash cycle with a reduction in receivables days from 49.19 in 2008 to 44.02 in 2009, offset somewhat by an increase in inventory days to 40.09 in 2009 from 37.68 in 2008.

Research in Motion LTD., Free Cash Margin, March 2000 – December 2009

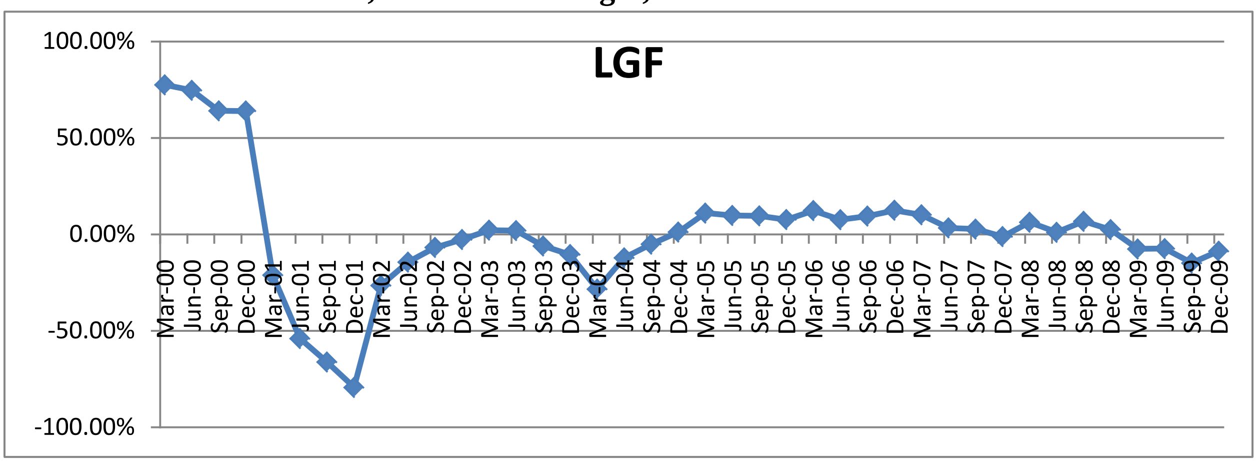


Research in Motion LTD (RIMM). Free cash margin improved to 13.55% for the twelve months ending December 2009 from 5.59% for the twelve months ending December 2008. RIMM's revenues have increased in every quarter since June 2006, however operating cushion, which remained flat between December 2008 and December 2009 is not driving an improvement in free cash flow. Rather, a decrease in capital expenditures as a % of revenue, a decrease in income taxes paid as a % of revenue, and a decrease in the cash cycle increased free cash margin. Capital expenditures as a % of revenue decreased from 7.53% in December 2008 to 6.75% in December 2009. Income taxes as a % of revenue decreased from 8.55% in December 2008 to 7.23% in December 2009. Finally, due to a decline in receivables days to 68.35 days in 2009 from 74.87 days in 2008 and a reduction in inventory days to 15.17 days from 22.51 days, the cash cycle declined adding to free cash flow.

Stable free cash margin

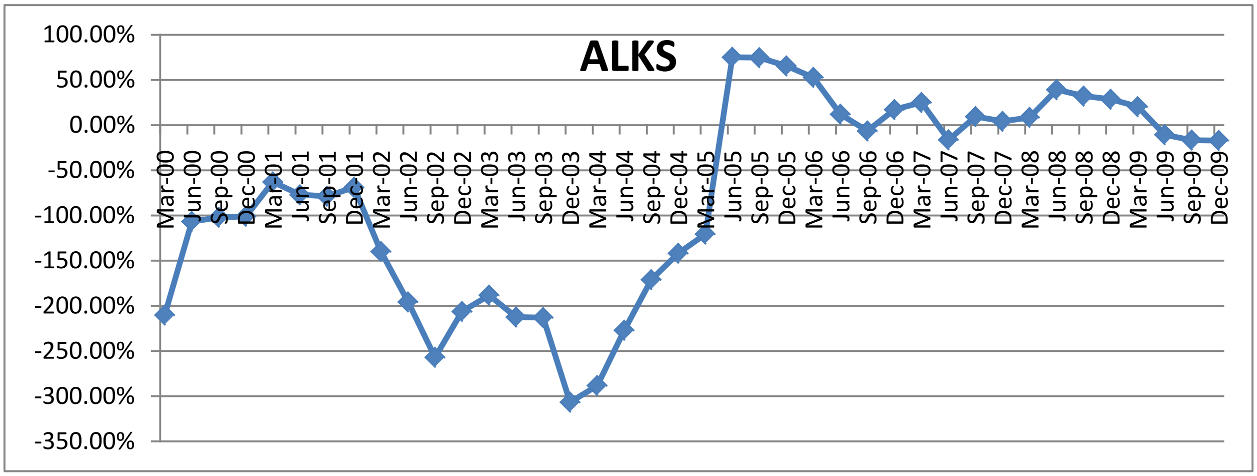
Free cash margin for the Media industry (GICS: 2540), Pharmaceuticals, Biotech and Life Sciences (GICS: 3520), and Telecommunication Services (GICS: 5010) were stable over the last twelve month period. However, three companies, Lions Gate Entertainment (LGF), Alkemes Inc (ALKS), and Tele Norte Lest Participaco (TNE), each exhibited a noticable decline in free cash margin over the prior year. We take a closer look at each of these companies next.

Lions Gate Entertainment., Free Cash Margin, March 2000 – December 2009



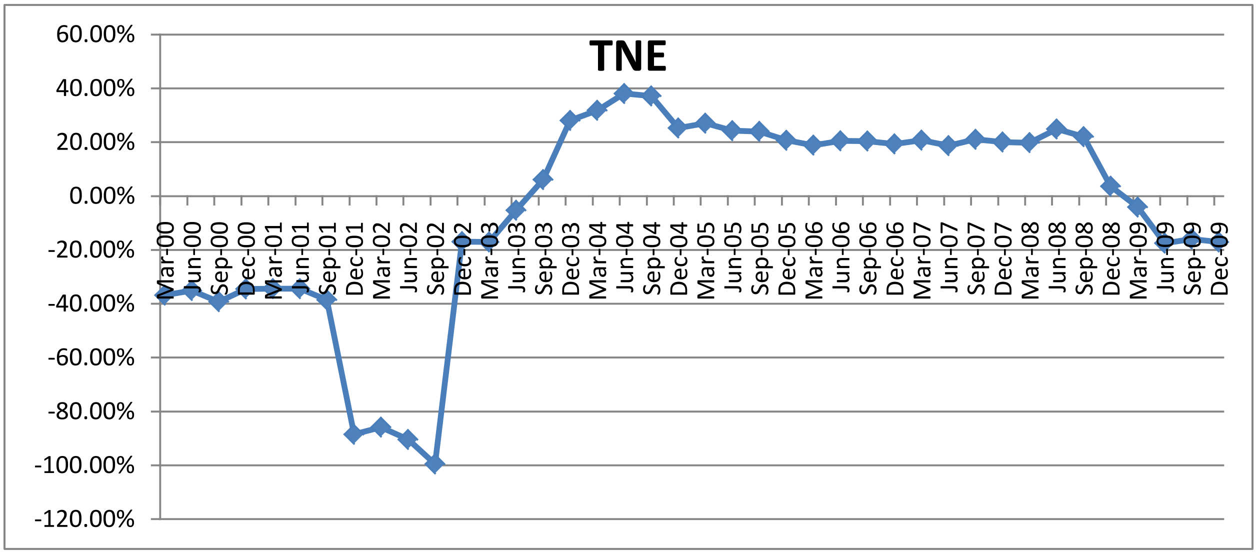
Lions Gate Entertainment (LGF): Free cash margin declined from 2.49% for the twelve months ending December 2008 to -8.70% for the twelve months ending December 2009. Operating cusion rose dramatically thanks to a decrease in SG&A as a % of revenue and an increase in gross margin as a % of revenue. Even though operating cushion increased from 26.28% in December 2008 to 39.18% in December 2009, an increase in the cash cycle, driven by an increase in receivables days to 57.67 in 2009 from 43.05 in 2008, and a reduction in payables days to 55.32 in 2009 from 66.89 in 2008, put downward pressure on free cash margin. Captial expenditures as a % of revenue were little changed, declining from .49% of revenue in 2008 to .40% in 2009.

Alkermes Inc (ALKS), Free Cash Margin, March 2000 – December 2009



Alkermes Inc (ALKS). Free cash margin declined to -17% for the twelve months ended December 2009 from 28.59% for the same period in December 2008. There were a number of factors, all working in concert, that pushed free cash margin lower. In particular, an increase in capital expenditures as a % of revenue, a decrease in operating cushion, and an increase in the cash cycle. Capital expenditures as a % of revenue increased from .35% in December 2008 to 5.61% in December 2009. Driven by an increase in SG&A as a % of revenue, operating cushion fell from 14.12% in December 2008 to 8.31% in December 2009. Finally, fueled primarily by an increase in receivable days to 56.10 days in 2009 from 48.95 days in 2008, the cash cycle increased, weighing on free cash margin.

Tele Norte Leste Participaco (TNE)., Free Cash Margin, 2000 – December 2009



Tele Norte Leste Participaco. (TNE): Tele Norte provides communication services in Brazil. Free cash margin declined from 3.62% for the twelve months ending December 2008 to -17.09% for the same period ending December 2009. Driving the decrease in free cash margin was a decrease in operating cushion, which fell from 33.78% in December 2008 to 25.23% in December 2009. Also contributing was an increase in prepaid expenses, which raised the cash cycle.

Conclusions

During the 4th quarter in 2009, overall free cash margin for all non-financial industries reached the highest point, 6.56%, since we began tracking the measure in March 2000. The continued increase is driven by a decrease in capital expenditures as a % of revenue and an increase in operating cushion. Attesting to their ability to control costs, even as revenues declined, managers were able to increase gross margin and reduce SG&A expenditures as a % of revenue. Additionally, inventory days increased for the second straight period, emphasizing an expectation for higher sales volumes in the near term. We will continue to monitor progress in future reports to see if companies can sustain this high free cash margin % with improved profitability.

Industry sectors with improving free cash flow were Energy, (GICS 1010), Materials (GICS 1510), Capital Goods (GICS 2010), Commercial and Professional Services (GICS 2020), Automobiles and Components (GICS 2510), Consumer Durables and Apparel (GICS 2520), Consumer Services (GICS 2530), Retailing (GICS 2550), Food and Staples Retailing (GICS 3010), and Food, Beverage and Tobacco (GICS 3020), Household and Personal Products (GICS 3030), Software and Services (GICS: 4510), Technology and Hardware (GICS:4520), and Utilities (GICS: 5510). No industry sectors showed declining free cash margin in the period. We will continue to update our findings, via our webpage, as new quarterly financial data become available.